

Feedback Statement, “Going Concern and Liquidity Risk: Guidance for Directors of UK Companies 2009”

Introduction

- 1.1 In May 2009, the Financial Reporting Council (FRC) issued an Exposure Draft of proposed Guidance for Directors of UK Companies on “Going Concern and Liquidity Risk” (the Guidance). The FRC intended that the Guidance should supersede the extant “Going Concern and Financial Reporting: Guidance for Directors of Listed Companies Registered in the UK” which was issued in 1994 (the 1994 Guidance).
- 1.2 Previously, the FRC had issued a Consultation Paper in September 2008 and an Update to the 1994 Guidance in November 2008. These publications were developed through an extensive informal consultation process with market participants.
- 1.3 The purpose of this Paper is to:
- (a) summarise the comments received in response to the Exposure Draft; and
 - (b) explain the key changes that the FRC made to the proposals in the Exposure Draft in finalising the Guidance.

Comments received

- 2.1 The FRC received 22 comment letters from the following market participant groups:

Preparers of financial statements and their advisers	7
Institutional investors	3
Accountancy bodies	4
Auditing firms	7
Individuals	1

- 2.2 21 of the comment letters have been placed on the public record by being posted to the FRC’s web-site. One commentator requested that his comments be kept confidential.
- 2.3 The FRC concluded, from evaluating the responses, that with relatively minor changes to the Exposure Draft that there was strong support for the issuance of the Guidance in final form and for the Guidance to be effective for December 2009 year ends.
- 2.4 The Exposure Draft posed 5 questions. A summary of the responses to these questions is set out below.

Changes made to the proposals arising from comments received

The Principles

- 3.1 Some commentators suggested that Principles 1 and 2 in the Exposure Draft should be combined because they address the same point; namely the assessment of whether the company is a going concern. Other commentators observed that the second paragraph of Principle 3 in the Exposure Draft, which relates to disclosure, would be better placed in Principle 4 “Disclosures”.
- 3.2 Some commentators recommended including in Principle 1 an acknowledgement that the directors should document their assessment of whether the company is a going concern. Some noted that for listed companies this will provide evidence necessary to support the auditor’s review (which is required by the Listing Rules) of the compliance of the directors’ going

concern statement with this Guidance.

3.3 In the Guidance, the FRC has:

- combined Principles 1 and 2 of the Exposure Draft. The Guidance, therefore, has three Principles rather than four;
- amended Principle 1 to recognise the need for documentation;
- moved the second paragraph of Principle 3 of the Exposure Draft into what was Principle 4 of the Exposure Draft; and
- presented the three Principles together on a single page (inside the front cover) so that company directors are able to appreciate the essence of the Principles before reading the balance of the Guidance.

Guidance for subsidiary companies

3.4 Some commentators remarked that the Exposure Draft provided insufficient guidance for the directors of subsidiary companies when assessing the going concern status of their company. In particular, the commentators were concerned that the Guidance should emphasise that directors of subsidiary companies need to exercise their independent judgment and should not merely rely on the assessment made by the directors of the group.

3.5 The FRC concurred with the commentators' concern and, accordingly, has enhanced the content of the Guidance in this regard. In particular, a new example illustrating disclosures that a subsidiary company might make has been included (see example 1(b) in Appendix II).

Application of the Guidance to non-listed companies

3.6 The Exposure Draft envisaged extending the 1994 Guidance to apply to all UK companies. The majority of commentators concurred with the proposed expansion of the scope. However, a representative body of preparers of financial statements expressed the view that the Guidance should not be mandatory for non-listed companies.

3.7 The document has the status of "Guidance". Therefore, none of it is "mandatory" in the sense that it is demanded by law or regulation. The Financial Reporting Standard for Smaller Entities (FRSSE) requires a going concern assessment to be made by the directors of smaller companies and, therefore, the FRC sees no reason to exempt directors of smaller companies from the Guidance, in particular the FRC draws attention to the guidance for directors of small companies that it issued in March 2009.

Significant recommendation from some commentators that has not been implemented in the Guidance

4.1 One institutional investor and one preparer commented, quite strongly, that they would prefer to prohibit additional disclosures being made about potential uncertainties where there is no doubt about the use of the going concern basis of accounting. One of these commentators noted that misunderstood or misleading information can easily cause panic in financial markets and that the approach in the Exposure Draft was likely to cause greater confusion for those entities where there is no doubt over the use of the going concern basis.

4.2 The FRC considered carefully the views expressed by these commentators but rejected their recommendations because:

- both IFRS and UK GAAP require disclosures to be made about a range of uncertainties and those disclosures benefit stakeholders;
- many other commentators held the opposite view that the FRC's proposals will be of benefit to users of annual reports of all companies; and

- the Listing Rules require directors of listed companies to make a going concern statement together with their assumptions regardless of their going concern status.

Implementation timetable

5.1 The majority of commentators supported the FRC's proposed implementation timetable. However, a significant minority supported it with respect to listed companies only and expressed the view that small companies and subsidiaries of groups may need longer to ensure that the appropriate level of evidence is obtained.

5.2 The FRC is sympathetic to the challenges described by commentators but takes the view that the Guidance does no more than reinforce existing obligations on directors. Further, the FRC has published a considerable amount of material on this subject (including guidance for small companies) over the last 18 months. Therefore, the FRC has concluded that the Guidance should be applicable to directors of all companies for periods ending on or after 31 December 2009.

6.1 Summary of responses to specific questions posed in the Exposure Draft:

1. Do you agree that the FRC should provide guidance on going concern relevant for directors of all companies? If so, do you believe that the Exposure Draft achieves this in a reasonably balanced way?

Those expressing agreement	20 (90%)
Those expressing some disagreement	1 (5%)
Those expressing no view	1 (5%)

2. Do you agree with the principles as drafted? If not how would you amend them?

Those expressing agreement	18 (81%)
Those expressing some disagreement	3 (14%)
Those expressing no view	1 (5%)

3. Do you agree with the three conclusions? If not, please suggest what alternatives you would suggest?

Those expressing agreement	18 (81%)
Those expressing some disagreement	3 (14%)
Those expressing no view	1 (5%)

4. Do you agree that the directors should disclose when the period they have considered is less than twelve months from the date of approval of half-yearly and interim financial statements that give a true and fair view?

Those expressing agreement	20 (90%)
Those expressing disagreement	-- (0%)
Those expressing no view	2 (10%)

5. Do you believe that it would be appropriate to replace the existing Guidance for Directors with this document for periods ending on or after 31 December 2009? If not, what alternative application date would you suggest?

Those expressing agreement	19 (85%)
Those expressing some disagreement	1 (5%)
Those expressing no view	2 (10%)